

**THE OFFICE OF REGULATORY STAFF
SURREBUTTAL TESTIMONY
OF
DANIEL F. SULLIVAN**



**DOCKET NO. 2006-97-W/S
APPLICATION OF
TEGA CAY WATER SERVICE, INC.
FOR ADJUSTMENT OF RATES AND CHARGES**

SURREBUTTAL TESTIMONY OF DANIEL F. SULLIVAN

FOR

THE OFFICE OF REGULATORY STAFF

DOCKET NO. 2006-97-W/S

IN RE: TEGA CAY WATER SERVICE, INC.

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY ON BEHALF OF THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF (“ORS”) IN THIS PROCEEDING?

A. Yes. I previously filed testimony concerning the ORS audit report in this proceeding.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of my surrebuttal testimony is to respond to the issues raised in the Tega Cay Water Service, Inc. (“TCWS”) rebuttal testimonies of witnesses Steven M. Lubertozi and Converse A. Chellis, III.

Q. WHAT IS YOUR POSITION REGARDING A PLANT ACQUISITION ADJUSTMENT (PAA) FOR TEGA CAY WATER SERVICE, INC.?

A. ORS removed the PAA from TWCS rate base by Adjustment #6 and from the calculation of net income for return through amortization of the PAA by Adjustment #21. These adjustments were made to reflect Accounting Instruction No. 13 of NARUC’s Uniform System of Accounts for Class B Water and Wastewater Utilities which states that “all amounts included in the accounts for utility plants acquired as

1 an operating unit or system shall be stated at the cost incurred by the person who first
2 devoted the property to utility service.” NARUC Uniform System of Accounts for
3 Class B Water & Wastewater Utilities, (NARUC, 1996). This rule was an outgrowth
4 of utility abuses of the 1920s and 1930s which lead to a “general consensus among
5 regulators” that the excess over net book value paid by the acquiring utility
6 “represented only a change in ownership without any increase in the service function
7 to utility ratepayers.” *Accounting for Public Utilities*, § 4.04 (Matthew Bender &
8 Co., Inc., Nov. 1999).

9 ORS recognizes that, in the years since the above rule was first published, many state
10 regulators, including the South Carolina Public Service Commission (PSC), have
11 allowed for both the recovery of and earnings on plant acquisition adjustments. As
12 cited by Mr. Lubertozzi, in his rebuttal testimony, sister companies of TWCS have
13 been allowed both positive and negative PAAs.

14 As indicated in Mr. Chellis’ rebuttal testimony, the actions of utility regulators have
15 been, at best, inconsistent from state to state and from utility to utility. ORS has
16 reviewed the same reference materials cited by both Mr. Lubertozzi and Mr. Chellis.
17 Based upon the inconsistencies in the allowance or denial of PAA in so many cases,
18 we have come to the conclusion that the award of PAA is done on a case by case
19 basis. In *Accounting for Public Utilities* at § 4.04 it is stated that, “the reasons most
20 commonly cited for allowing rate base and/or cost of services treatment of
21 acquisition adjustments are as follows:

1 (1) when acquisitions represent an essential or desirable part of an integration of
2 facilities program devoted to serving the public better;

3 (2) when acquisitions are clearly in the public interest, because operating efficiencies
4 offset the excess price over net original cost; and

5 (3) when acquisitions are determined to involve arm's-length bargaining.”

6 In his rebuttal testimony, Mr. Chellis cites a fourth commonly cited reason for
7 including PAA in rate base and/or cost of service as “the terms of the acquisition
8 agreement receive prior regulatory approval.”

9 Furthermore, Mr. Chellis’ rebuttal testimony states that “in Order No. 91-1052 in
10 Docket No. 91-453-W/S, the Commission approved the transfer of the assets of Tega
11 Cay Utilities, Inc. to TCWS finding at page 4 of its order that TCWS was ‘fit, willing
12 and able to operate the water and sewer systems in Tega Cay and that transfer of the
13 water and wastewater systems presently owned by TCU, Inc. to Tega Cay Water
14 Service, Inc. should be approved.’ Similarly, the Commission found on page 3 of
15 Order No. 95-1209 in Docket No. 95-660-W, that the transfer of the River Pines
16 water system to TCWS was ‘in the public interest’ and that the transfer should be
17 granted.” ORS recognizes that the Commission did grant transfer of the Tega Cay
18 Utilities, Inc. and River Pines systems to TCWS, but notes there is no mention of the
19 Commission granting a PAA to TCWS in either of the orders approving transfer.

20 To date, ORS has not received documentation from TWCS as to their having met any
21 of the above cited reasons. As such, we have proposed excluding any effects that
22 PAA might have on this proceeding.

1 Further, both TCWS and the PSC staff proposed to remove the plant acquisition
2 adjustment and amortization of the plant acquisition adjustment in Docket No. 96-
3 137-W/S. Mr. Lubertozi states in his rebuttal testimony that “contrary to the
4 suggestion made by Mr. Sullivan in his testimony, the plant acquisition adjustment
5 was not removed from rate base in the Company’s last rate case since there was no
6 effort on the Company’s part to obtain rate base treatment.” In fact, the company did
7 include Schedule B showing the Test Year and Pro Forma Income Statement in the
8 application filed in Docket No. 96-137-W/S including Adjustment (l) that states
9 “Amortization of PAA is removed for ratemaking purposes.” The company also
10 included Schedule D showing Rate Base and Rate of Return in the application filed
11 in Docket No. 96-137-W/S including Adjustment (d) that states “Plant Acquisition
12 Adjustment is removed for ratemaking purposes.”

13 ORS does acknowledge that TCWS filed for an adjustment in rates based on
14 operating margin in Docket No. 96-137-W/S rather than requesting rate base
15 treatment. That notwithstanding, removing the PAA and amortization of the PAA in
16 Docket No. 96-137-W/S did have an effect on the resulting operating margin. If
17 TCWS had included amortization of the PAA in the last rate case, expenses would
18 have increased resulting in a decrease in net income. If TCWS had included the
19 PAA in rate base, interest expense would have increased since interest expense is
20 calculated using rate base, income for return, the company’s debt/equity ratio and its
21 cost of debt. Interest expense reduces net income before the computation of the
22 operating margin. Furthermore, Order No’s. 96-879, 97-126 and 1999-191 resolving

1 Docket No. 96-137-W/S did not indicate differing treatment of the PAA or
2 amortization of the PAA by the Commission from that proposed by TCWS and PSC
3 staff.

4 **Q. WHAT IS YOUR POSITION REGARDING OPERATORS' SALARIES?**

5 A. ORS annualized operators' salaries using wage rates in effect as of May 2006 and the
6 latest available wage allocation factors as of September 30, 2005 (ORS Adjustment
7 #9). ORS did not include the 4% salary increase proposed by TCWS as the
8 supporting documentation for the increase was not received by ORS in sufficient
9 time to allow for its audit.

10 **Q. WHAT IS YOUR POSITION REGARDING OPERATING EXPENSE**
11 **CHARGED TO PLANT?**

12 A. ORS calculated operating expense charged to plant in Adjustment #11 based on total
13 operators' salaries, taxes and benefits as calculated for Adjustment #9 and a 12.53%
14 capitalization percentage. ORS's adjustment to operating expense charged to plant
15 did not include the 4% salary increase proposed by TCWS as the supporting
16 documentation for the increase was not received by ORS in sufficient time to allow
17 for its audit.

18 **Q. WHAT IS YOUR POSITION REGARDING OFFICE SALARIES?**

19 A. ORS annualized office salaries using wage rates in effect as of May 2006 and the
20 latest available wage allocation factors as of September 30, 2005 (ORS Adjustment
21 #12). ORS did not include the 4% salary increase proposed by TCWS as the

1 supporting documentation for the increase was not received by ORS in sufficient
2 time to allow for its audit.

3 **Q. WHAT IS YOUR POSITION REGARDING RATE CASE EXPENSE?**

4 A. ORS amortized actual current rate case expenses over a three year period in
5 Adjustment #13. ORS acknowledges that TCWS will incur additional costs for the
6 rate case proceeding. ORS included only known and measurable rate case expense
7 as of June 19, 2006 in its computation of rate case expense for testimony and
8 exhibits.

9 **Q. WHAT IS YOUR POSITION REGARDING PENSION AND OTHER**
10 **BENEFITS?**

11 A. ORS calculated pension and other benefits in Adjustment #14 based on total
12 operators and office salaries as calculated for Adjustment #9 and Adjustment #12.
13 ORS's adjustment to pension and other benefits did not include the 4% salary
14 increase proposed by TCWS as the supporting documentation for the increase was
15 not received by ORS in sufficient time to allow for its audit.

16 **Q. WHAT IS YOUR POSITION REGARDING NON-ALLOWABLE**
17 **EXPENSES?**

18 A. ORS made Adjustment #15 to remove \$403 of non-allowable expenses comprised of
19 \$260 for Chamber of Commerce dues and \$143 for a 7 day personal newspaper
20 subscription. The Chamber of Commerce dues were for 2005 membership dues to
21 the Lake Wylie Chamber of Commerce totaling \$520. ORS removed one half of
22 these dues due to the Commission's vote in Docket No. 93-503-C, which was to

1 remove one half of Chamber of Commerce dues and expenditures for utility rate
2 cases. ORS removed the 7 day personal newspaper subscription for the Charlotte
3 Observer in the amount of \$143 since there was no indication on the subscriber
4 renewal notice that the 7 day newspaper subscription was for Tega Cay Water
5 Service, Inc.

6 **Q. WHAT IS YOUR POSITION REGARDING DEPRECIATION EXPENSE**
7 **AND ACCUMULATED DEPRECIATION?**

8 A. ORS calculated depreciation expense and accumulated depreciation in Adjustment
9 #16 and Adjustment #27, respectively. ORS included all pro forma plant,
10 retirements, capitalized time and general ledger additions as of June 2006 as
11 documented by the company and determined used and useful by ORS. ORS omitted
12 one Bio-Tech invoice in the amount of \$14,937.97 that was for repair and painting of
13 well buildings at well sites that were determined not used or useful in Docket No. 96-
14 137-WS. ORS did not include depreciation or accumulated depreciation for the Bio-
15 Tech invoice amount of \$14,937.97 since the work performed was for plant not used
16 or useful.

17 **Q. WHAT IS YOUR POSITION REGARDING TAXES OTHER THAN**
18 **INCOME?**

19 A. ORS calculated the adjustment to payroll taxes in Adjustment #17 based on total
20 operators and office salaries as calculated for Adjustment #9 and Adjustment #12.
21 ORS's adjustment to payroll taxes did not include the 4% salary increase proposed

1 by TCWS as the supporting documentation for the increase was not received by ORS
2 in sufficient time to allow for its audit.

3 **Q. WHAT IS YOUR POSITION REGARDING AMORTIZATION OF THE**
4 **PLANT ACQUISITION ADJUSTMENT?**

5 A. See ORS's position on the PAA as noted in our response to Mr. Lubertozi's and Mr.
6 Chellis' rebuttal of ORS Adjustment #6 and Adjustment #21 above.

7 **Q. WHAT IS YOUR POSITION REGARDING GROSS PLANT IN SERVICE?**

8 A. ORS included all pro forma plant, retirements, capitalized time and general ledger
9 additions as of June 2006 as documented by the company and determined used and
10 useful by ORS. ORS omitted one Bio-Tech invoice in the amount of \$14,937.97 that
11 was for repair and painting of well buildings at well sites that were determined not
12 used or useful in Docket No. 96-137-WS.

13 **Q. WHAT IS YOUR POSITION REGARDING CASH WORKING CAPITAL?**

14 A. ORS calculated cash working capital in Adjustment #28 using maintenance and
15 general expenses after ORS accounting and pro forma adjustments.

16 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

17 A. Yes, it does.
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